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HOW DOES THIS RECOVERY MEASURE UP?

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Continued economic and employment growth, as well as the recent drop in the deficit, have led to renewed debate over the nature of the economic recovery. Some proponents of the 2001 and 2003 tax cuts have argued that these developments validate their claims about the positive effects of those tax cuts.

Our assessment of a broad range of key economic indicators, however, suggests that this economic recovery is not especially robust. To the contrary, relative to comparable past periods, the current economic recovery has, on balance, been worse than average. The economic performance of the past four years also has been no better than the economic recovery of the early 1990s, which occurred in years following a significant tax *increase*; in terms of job creation, this recovery has been far worse. In short, the economy's overall performance does not make up for the adverse fiscal effects of the recent tax cuts or the unusually uneven distribution of the economic gains from this recovery.

Here we examine Commerce Department, Labor Department, and Federal Reserve Board data on seven economic indicators: gross domestic product, personal consumption expenditures, private domestic fixed non-residential investment, net worth, income from wages and salaries, employment, and corporate profits. For each indicator, we look at average growth both since the business-cycle trough in November 2001 (at which point the recovery began) and since the last business-cycle peak in March 2001. We compare average growth over these periods with average growth over comparable business periods since the end of World War II.[1] Growth is measured after adjusting for inflation (except for employment levels, where such an adjustment is inapplicable).

- For six of the seven indicators, growth rates over the current period are below the average of the growth rates for the comparable post-war periods. Notably, the economy has underperformed in this recovery (i.e., does less well than the post World War II average) with respect to GDP growth and growth of fixed non-residential investment, indicators that should have captured any positive growth effects of the tax cuts.

[1] We take comparable periods to be periods of equal length as measured from the trough or peak of the business cycle, as identified by the National Bureau of Economic Research (the arbiter of the starting and ending points of business cycles). We generally look at data through the second quarter of 2005. For net worth, wages and salaries, and corporate profits, data are available only through the first quarter of 2005. Employment levels are available through July 2005.

- The labor market also has fared less well during this period. Employment and wage and salary growth are especially slow in the current period, underperforming not only the historical average but, in the case of employment growth, *every* comparable period since the end of World War II. The pace of job growth has picked up this year, but even this more recent pace compares unfavorably with historical patterns.

- The current period has outperformed the average only in one respect: corporate profits, which have grown far more rapidly than average.

- These conclusions hold whether one focuses on comparisons examining the period since the recovery began or the period since the last expansion ended.

The Current Recovery Period

As shown in Table 1, we look at the performance of these indicators in two ways: since the recovery began in November 2001 (the fourth quarter of 2001) and since the last economic peak (the first quarter of 2001). This section focuses on the recovery period.

GDP, consumption, investment, and net worth have all grown less rapidly than during other comparable periods. It is notable that net worth has grown relatively slowly despite the big jump in the value of housing. Fixed non-residential investment has grown at a rate that has fallen short of its growth rate in all but one other comparable post-war period.[2]

Labor market progress has been relatively modest.[3] Employment has grown at an average annual rate of only 0.5 percent since November 2001, as compared with an average for previous comparable post-World War II periods of 2.6 percent. Relatedly, wages and salaries have grown at a 2.0 percent rate, less than half their average annual rate of 4.2 percent in other recoveries since the end of World War II.

Note that even the most recent pace of job growth lags behind the typical pace. In July 2005, for example, some 207,000 jobs were created. This welcome amount of job growth received substantial attention and reflects a faster pace of job creation than during the earlier parts of the recovery; job growth from June to July itself occurred at three times the pace of job growth during the rest of the recovery. Still, job growth in July occurred at a *slower* pace than the average of other post-World War II recoveries. If the pace of job creation in July 2005 had been the same as the average pace of job creation of all other recoveries since the end of World War II,[4] some 252,000 jobs would have been created.

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[2] We consider fixed non-residential investment, as opposed to total gross domestic investment, in order to ensure that we capture growth of the productive capital stock rather than growth of inventories or housing construction. (The appreciation in the value of housing is reflected in the net worth data.) Considering gross domestic investment, however, would not change our conclusions. Gross investment growth has averaged 6.8 percent during the recovery, as compared with a post-war average of 10.2 percent.

[3] We did not examine changes in the unemployment rate here as the current unemployment rate does not appear to be the best measure of the state of the labor market. At least in part, its low level reflects unusually slow growth in the labor force.

[4] This average reflects all months of job growth through the 44th month of a recovery. As noted, July 2005 marked the 44th month of this recovery.

Corporate profits have fared exceptionally well. The sole exception to the current period's lackluster performance has been the growth rate of corporate profits, which have experienced annual average growth of 15.1 percent in the current period, as compared with an average of 9.5 percent for other comparable post-war periods.

An uneven recovery. Exceptionally fast growth in corporate profits, coupled with exceptionally slow growth in wages and salaries, is consistent with other evidence showing that the distribution of economic gains during the current recovery period has been unusually uneven. As noted in a recent story in *The Washington Times*, which reported on some of the same data examined here, "The revival [in income growth] is mainly among top earners who receive stocks, bonuses and other income in addition to wages."[5] The *Times* story also drew heavily on July congressional testimony by Federal Reserve Chairman Alan Greenspan, during which he also noted the growth in income disparities.[6]

Further, the Congressional Budget Office (CBO) has said that one possible reason that revenues are coming in faster than it forecast earlier this year is that increases in personal income have been more concentrated among high-income taxpayers than it anticipated.[7] High-income taxpayers generally pay taxes at higher rates, so an increasing concentration of income results in a higher level of revenues.

Comparisons Measuring from Economic Peaks

Above, we compare the current economic recovery with others by measuring growth rates from the trough of the business cycle. Some may argue that this comparison disadvantages the current recovery because it followed a relatively mild recession. All else being equal, one would expect the economy to grow more quickly after a deep recession than after a shallow one.

To account for the possibility that starting from the trough skews the results, we also compare growth of the same variables during the entire current business cycle period (starting from the peak of the last business cycle in March 2001) with growth during comparable portions of the other previous post-war business cycles. Using this approach does not change any of our central conclusions. Growth in the current period continues to fall short of the post-war average for all indicators except corporate profits (see Table 1). Wage and salary, employment, and investment growth still appear exceptionally weak. Growth in wages and salaries and employment underperformed not only the average for comparable post-war periods but every individual comparable period. Fixed non-residential investment has grown at an average rate of 0.9 percent since the last business-cycle peak, which is below its growth rate in all but one previous comparable post-war periods and far below the 3.4 percent historical average for comparable post-war periods.

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[5] Patrice Hill, "Income gap grows in U.S.," *The Washington Times*, July 31, 2005, page A1.

[6] Alan Greenspan, Chairman of the Federal Reserve Board, Testimony before the House Financial Services Committee, July 30, 2005.

[7] Congressional Budget Office, "Monthly Budget Review," May 2005.

Comparisons to the Economic Cycle of the early 1990s

A comparison of the current period with the economic cycle of the early 1990s yields a more mixed picture, whether measured since the trough of the downturn or relative to the last economic peak. (Again, see Table 1.)

- GDP and personal consumption expenditure growth differed little during the two periods.
- Net worth has grown modestly faster during this period than in the early 1990s.
- Corporate profits have increased roughly twice as fast during the current period as in the earlier period.
- But labor market indicators have been significantly weaker during this period. For instance, during this economic recovery, job growth has occurred at just one-third of the pace that it did during the comparable part of the economic recovery of the early 1990s.
- Fixed non-residential investment also has grown significantly more slowly during this economic cycle. During this recovery, it has grown at a 3.7 percent annual rate, well below the 5.7 percent annual rate at which it grew over the comparable portion of the early 1990s recovery.

The Dismal Fiscal Consequences

The data above suggest that the tax cuts of the past few years did not lead to a shining economic performance. Indeed, even relative to the early 1990s when taxes were increased significantly during the early stages of the recovery, the performance in the current period does not stand out.

While the tax cuts thus do not appear to have delivered exceptionally good outcomes for the economy, they have contributed to an exceptionally sharp deterioration in the fiscal situation. Since the last economic peak, the budget has swung from a surplus of 1.9 percent of GDP to a deficit of 2.7 percent of GDP,[8] with the deterioration in the fiscal gap amounting to 4.6 percent of GDP. This is more than three times the average percentage point increase in the budget deficit of 1.3 percent of GDP during equivalent post-World War II periods.

The tax cuts explain a large share of this differential. The official cost estimates of Congress' Joint Committee on Taxation suggests that in fiscal year 2005, the cost of the tax cuts will total about two percent of the economy.

[8] The recent peak occurred during the second quarter of fiscal year 2001. To calculate the surplus at this point we used a "weighted average" of the surplus for fiscal year 2001 as a whole (1.3 percent) and the surplus for fiscal year 2000 (2.4 percent). The current deficit of 2.7 percent reflects the latest estimate by OMB for the deficit for fiscal year 2005.

TABLE 1: Annual Growth Rate Comparisons

Growth Rates Measured from Trough

	GDP (c)	Consumption (c)	Non-Residential Fixed Investment (c)	Net Worth (d)	Wages and Salaries (d)	Employment (d)	Corporate Profits (d)
Current Recovery	3.27%	3.17%	3.66%	2.86%	1.95%	0.60%	15.09%
Post-War Average	4.71%	4.21%	6.61%	3.87%	4.23%	2.29%	9.54%
1990s	3.19%	3.29%	5.69%	1.61%	2.14%	1.78%	6.03%

Growth Rates Measured from Peak

	GDP (a)	Consumption (a)	Non-Residential Fixed Investment (a)	Net Worth (b)	Wages and Salaries (b)	Employment (d)	Corporate Profits (b)
Current Recovery	2.77%	3.18%	0.85%	2.53%	0.94%	0.22%	12.10%
Post-War Average	3.29%	3.51%	3.42%	3.38%	2.65%	1.55%	4.34%
1990s	2.60%	2.66%	4.61%	2.33%	1.35%	1.24%	6.91%

(a) Average growth rate in 17 quarters after peak. Current recovery: 2001-I:2005-II. 1990s: 1990-III:1994-IV. Post-war average includes 1990s and 1948-IV:1953-I, 1953-III:1957:IV, 1957-III:1961-IV, 1960-II:1964-III, 1969-IV:1974-I, 1973-IV:1978-1, 1980-I:1984-II, 1981-III:1985-IV

(b) Average growth rate in 16 quarters after peak. Current recovery: 2001-I:2005-I. 1990s: 1990-III:1994-III. Post-war average includes 1990s and 1948-IV:1952-IV, 1953-III:1957:III, 1957-III:1961-III, 1960-II:1964-II, 1969-IV:1973-IV, 1973-IV:1977-IV, 1980-I:1984-I, 1981-III:1985-III

(c) Average growth rate in 14 quarters after trough. Current recovery: 2001-IV:2005-II. 1990s: 1991-I:1994-III. Post-war average includes 1990s and 1949-IV:1953-II, 1954-II:1957-IV, 1958-II:1961-IV, 1961-I:1964-III, 1970-IV:1974-II, 1975-I:1978-III, 1980-III:1984-I, 1982-IV:1986-II.

(d) Average growth rate in 44 months after trough and 52 months after peak. Most recent trough was in November 2001 (44 months ago); most recent peak was in March 2001 (52 months ago).

Post-war averages for net worth exclude the 1948 peak and 1949 trough due to lack of data.

Sources

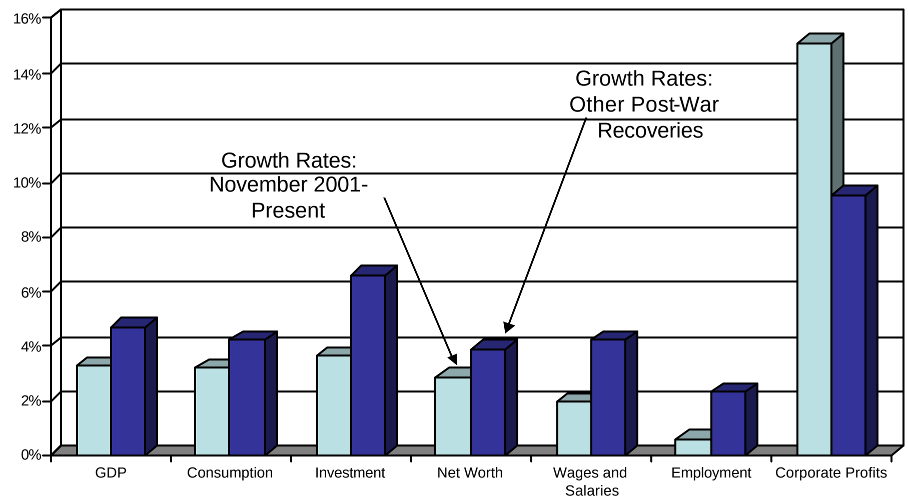
GDP, consumption, non-residential investment, wages and salaries, and corporate profits data: Bureau of Economic Analysis.

Employment data: Bureau of Labor Statistics.

Net worth data: Federal Reserve Board Statistical Release, Flow of Funds Accounts of the United States.

FIGURE 1

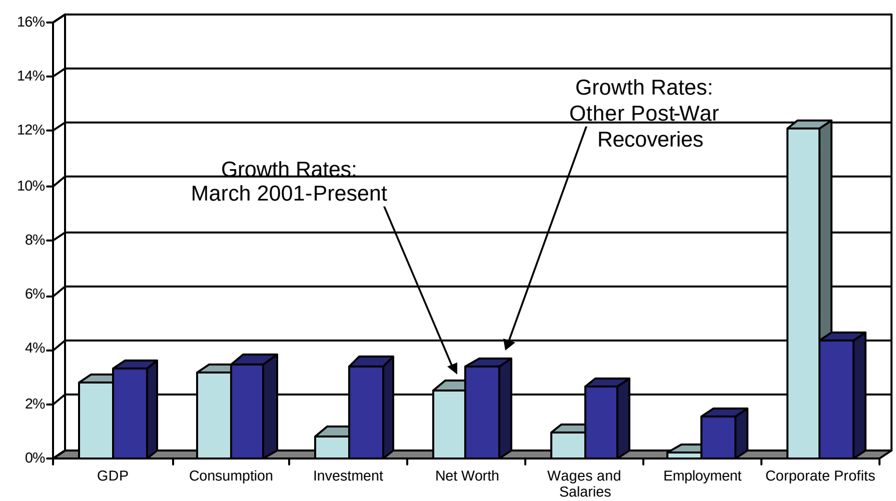
Growth Rates of Major Economic Indicators (Measured from Business Cycle Trough)



Source: CBPP calculations based on Commerce Department, Labor Department, and Federal Reserve Board Data

FIGURE 2

Growth Rates of Major Economic Indicators (Measured from Business Cycle Peak)



Source: CBPP calculations based on Commerce Department, Labor Department, and Federal Reserve Board Data